

To: City Council  
From: Lenda Crawford, Finance Director  
Date: March 1, 2006  
Subject: Impact of New Microsoft Development on City Revenues

Microsoft has recently announced that it would accelerate its expansion plans in Redmond. Growth that was expected to take place over a 10-year period is now planned within the next three years. This acceleration has prompted questions from Council about the effect of this development upon city revenues. The purpose of this memo is to respond to those questions.

According to the City's Planning Department, this new development will be significant, adding about 2.6 million square feet of new office space and replacing 800,000 square feet of existing space on the Microsoft campus for a total of 3.4 million square feet over the next three years. Additionally, 4.9 million square feet of garage space will be constructed on the campus. The development is estimated at a value of \$845 million including furnishings and equipment and breaks down as follows: new space - \$714 million and renovated space - \$131 million.

Under normal circumstances, it would be reasonable to expect that a development of this size would have a significant impact upon city revenues. However, the effect on revenues is expected to be modest for the reasons outlined below:

- **Reason #1:** The high-tech sales tax exemption legislation, which was approved by the State Legislature in 1995/96, will allow Microsoft to apply for and in all likelihood receive a sales tax exemption on the new development under the auspices of research and development.

The sales tax exemption legislation allows high-tech companies that construct buildings for research and development purposes to exempt those buildings including all furnishings and equipment from state and local sales tax requirements. Microsoft's previous practice has been to apply for this exemption for nearly all of its new buildings over the last ten years, resulting in a significant loss of sales tax revenue to Redmond. If Microsoft follows the same practice and receives an exemption, it is estimated the City will lose millions of dollars in the form of sales tax revenue over the next three years.

**This loss in revenue would occur as the responsibility for delivering city services such as police, fire, parks, street maintenance, etc. and maintaining infrastructure increase dramatically.** Please note that the estimated amount of the sales tax loss is not disclosed because the City is prohibited under state law from releasing company specific

sales tax data. However, global data on the high-tech sales tax exemption program may be shared. According to the Department of Revenue, **forty-six Redmond based firms including Microsoft have applied for and received the high-tech sales tax exemption, resulting in a loss of \$14.9 million in sales tax revenue through 2005.**

- **Reason #2:** Redmond's property tax rate is very low and will limit the amount of property tax revenue the city will receive from this development.

For 2006, the City's property tax rate is \$1.23 per \$1,000 of assessed value. Given the projected value of the new space (\$714 million) and the City's current property tax rate, over the next three years, Redmond would receive an average of \$293,000 annually in property tax revenue. If a levy lid lift of \$.65 per \$1,000 of assessed value is approved by the voters, this new development would generate an additional \$155,000 per year on average. It is important to note that all of the additional property tax revenue from this development has been incorporated into the City's Six-Year Financial Forecast. The Forecast assumes that \$2.4 billion in new construction will be added to the City's property tax rolls from 2007 through 2012.

- **Reason #3:** Microsoft's development review fees will no longer subsidize smaller commercial and residential projects effective with the new fee schedules.

Effective March 1 and May 1, 2006, the new development review fee schedules are slated to go into effect. Under these new schedules, Microsoft will pay only for the cost of processing its development permits. This is different than in years past when Redmond's development review fees were based upon the value and size of a project in accordance with the Uniform Building Code (UBC). The UBC fee structure resulted in larger projects like Microsoft subsidizing the smaller ones. Redmond's new fee structure is based on full cost recovery and has eliminated the subsidies that were inherent in the UBC. Therefore, Microsoft will only pay for the services it receives which will result in the company paying less in the future for development review services than it paid in previous years. To the extent that subsidies are allowed on smaller projects after the new fee schedules go into effect, these subsidies will be paid for by the City's General Fund.

- **Reason #4:** Utility tax revenues are not expected to be very significant.

Based upon current electric and natural gas rates, it is estimated that the new development would generate over the next three years an average of \$77,000 of electric and natural gas utility taxes annually. There is currently not enough information available to determine how much revenue the City would receive from new telephone services. However, given the decline that Redmond has experienced in this category, it is expected that Microsoft will also avail itself of cheaper telephone alternatives such as the Internet, thereby limiting the amount of telephone utility tax revenue to the City.

In conclusion, while Microsoft is making a significant investment in Redmond, the revenue the City will receive is expected to be modest as summarized below. It is important to note that **nearly all of this revenue has been incorporated into the City's Six-Year Financial Forecast.**

### **Effect of New Microsoft Development on City Revenues**

	<b>Avg. Annual Increase <u>Over 3-Years</u></b>
Sales Tax	Exempt
Property Tax	\$293,000
Development Review Fees	Revenue Neutral
Electric & Gas Utility Taxes	\$ 77,000 (at build-out)
Telephone Utility Taxes	<u>?????????</u>
<b>Total On-Going Revenue Based on Existing Tax Structure</b>	<b>\$370,000</b>
<b>\$.65 Levy Lid Lift</b>	<b><u>\$155,000</u></b>
<b>Total If Levy Lid Lift Approved</b>	<b>\$525,000</b>

It is likely that other jurisdictions in the Puget Sound region may benefit more from Microsoft's new development than Redmond. The City does not have the tax structure in place to take advantage of the wealth within its boundaries or the large developments at Microsoft. As stated above, the high-tech sales tax exemption has had and will continue to have a negative impact on Redmond's ability to capitalize on growth within its community and continue to deliver high quality services/infrastructure.